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# NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

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## MBA PROFESSIONAL REPORT

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**Exploitation of Free Markets  
and Globalization to Finance Terrorists**

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**By: Claudia P. Pena-Guzman  
September 2008**

**Advisors: Joseph G. San Miguel  
Michael Freeman**

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<b>REPORT DOCUMENTATION PAGE</b>			<i>Form Approved OMB No. 0704-0188</i>	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.				
<b>1. AGENCY USE ONLY (Leave blank)</b>		<b>2. REPORT DATE</b> September 2008	<b>3. REPORT TYPE AND DATES COVERED</b> MBA Professional Report	
<b>4. TITLE AND SUBTITLE</b> Exploitation of Free Markets and Globalization to Finance Terrorists			<b>5. FUNDING NUMBERS</b>	
<b>6. AUTHOR(S)</b> Claudia P. Pena-Guzman				
<b>7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)</b> Naval Postgraduate School Monterey, CA 93943-5000			<b>8. PERFORMING ORGANIZATION REPORT NUMBER</b>	
<b>9. SPONSORING /MONITORING AGENCY NAME(S) AND ADDRESS(ES)</b> N/A			<b>10. SPONSORING/MONITORING AGENCY REPORT NUMBER</b>	
<b>11. SUPPLEMENTARY NOTES</b> The views expressed in this study are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.				
<b>12a. DISTRIBUTION / AVAILABILITY STATEMENT</b> Approved for public release; distribution is unlimited			<b>12b. DISTRIBUTION CODE</b>	
<b>13. ABSTRACT (maximum 200 words)</b> <p>The international community has taken measures to monitor financial networks through anti-money laundering acts, which since 9/11 have expanded to cover terrorist financing. However, the strides made to date in some parts of the world have been limited and gaps still exist that terrorist organizations can infiltrate to thwart the international community's efforts.</p> <p>The purpose of this study is to investigate and provide an overview of current international counter-terrorist financing efforts and focus on how terrorists exploit them. This project was conducted as a study of three cases looking at globalization and free markets. Colombia is the primary case, while Peru and Great Britain are secondary cases. The goal of this project was to identify and document the trends in these countries in terms of existing exploitable vulnerabilities. Specifically in Colombia, the study focuses on the FARC, ELN and AUC, and how the Colombian government and financial institutions have responded. In Peru, the focus of the examination is Sendero Luminoso, and in Great Britain, it is the Irish Republican Army in Northern Ireland.</p>				
<b>14. SUBJECT TERMS</b> Colombia, Terrorism, Globalization, Marketization, Drug Trafficking, Drug Revenues, Coca Cultivation, Narco-Guerilla Groups, FARC, ELN, AUC, Plan Colombia, Second Order Effects, Financing			<b>15. NUMBER OF PAGES</b> 69	
			<b>16. PRICE CODE</b>	
<b>17. SECURITY CLASSIFICATION OF REPORT</b> Unclassified	<b>18. SECURITY CLASSIFICATION OF THIS PAGE</b> Unclassified	<b>19. SECURITY CLASSIFICATION OF ABSTRACT</b> Unclassified	<b>20. LIMITATION OF ABSTRACT</b> UU	

NSN 7540-01-280-5500

Standard Form 298 (Rev. 2-89)  
Prescribed by ANSI Std. Z39-18

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**EXPLOITATION OF FREE MARKETS  
AND GLOBALIZATION TO FINANCE TERRORISTS**

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Submitted in partial fulfillment of the requirements for the degree of

**MASTER OF BUSINESS ADMINISTRATION**

from the

**NAVAL POSTGRADUATE SCHOOL  
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# **EXPLOITATION OF FREE MARKETS AND GLOBALIZATION TO FINANCE TERRORISTS**

## **ABSTRACT**

The international community has taken measures to monitor financial networks through anti-money laundering acts, which since 9/11 have expanded to cover terrorist financing. However, the strides made to date in some parts of the world have been limited and gaps still exist that terrorist organizations can infiltrate to thwart the international community's efforts.

The purpose of this study is to investigate and provide an overview of current international counter-terrorist financing efforts and focus on how terrorists exploit them. This project was conducted as a study of three cases looking at globalization and free markets. Colombia is the primary case, while Peru and Great Britain are secondary cases. The goal of this project was to identify and document the trends in these countries in terms of existing exploitable vulnerabilities. Specifically in Colombia, the study focuses on the FARC, ELN and AUC, and how the Colombian government and financial institutions have responded. In Peru, the focus of the examination is Sendero Luminoso, and in Great Britain, it is the Irish Republican Army in Northern Ireland.



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## **ACKNOWLEDGMENTS**

I dedicate this study to and thank my husband Ivan and my children Miguel and Gabriela for their love and unwavering support. To all my professors, mentors and peers this has been a memorable experience.



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# **I. INTRODUCTION TO ISSUES ARISING FROM GLOBALIZATION AND FREE MARKETS**

## **A. BACKGROUND AND SCOPE OF THE STUDY**

The international community has taken measures to monitor financial networks through anti-money laundering acts, which since 9/11 have expanded to cover terrorist financing. The primary vehicle has been the independent, inter-governmental policy-making body, the Financial Action Task Force on Money Laundering (FATF) and its regional affiliates.<sup>1</sup> However, the strides made to date in some parts of the world have been limited and gaps still exist that terrorist organizations can infiltrate to thwart the international community's efforts. With the global interconnectivity between nations, increasing because of globalization, a gap or shortcoming in one nation renders all other nations vulnerable to terrorists and criminal activity. By identifying how terrorist organizations are taking advantage of systems of financial globalization and free markets effective policy changes can be made. Policy changes such as changes to current monitoring measures and entry requirements by individuals or corporations into financial markets and banking institutions can effectively diminish or cut off terrorist finances. The result would delegitimize terrorists while denying them the capability to continue to conduct operations.

## **B. STUDY ROAD MAP**

Colombia was selected as the primary case for this study due to its long history of insurgency and terrorism from both left and right wing groups and its democratic and economic evolution over the past fifty years. The subsequent cases of Peru, and Great Britain (Northern Ireland) were chosen because of their differing financial roles in the global free market economy and their history of dealing with terrorism. Peru and Great Britain (Northern Ireland) were also selected due to the divergent approaches their

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<sup>1</sup> James Jackson, "CRS Report for Congress: The Financial Action Task Force- An Overview," *Congressional Research Service*, Order Code RS21904, Updated March 4, 2005.

government chose to deal with terrorism. These countries' actions against the terrorist organizations may have fueled the terrorists' determination rather than counter it.

The four elements studied for examining how terrorist organizations take advantage of financial globalization and free markets to finance their activities were each individual country's: 1) economy; 2) financial markets and banking system; 3) auditing and internal monitoring; and 4) international cooperation. The basis for the research is derived from public documents, articles in academic journals, and published books. Works from numerous academic sources in the field of terrorist financing and economic crime were used to outline the current practices in the international community to counter terrorist financing and identify existing gaps that terrorists can and do exploit.

This chapter offers a literature review that encompasses works from scholars and analysts on terrorism and democracy, terrorist financing and globalization, and international efforts to counter terrorist financing. The studies of relationship between terrorism and democracy are examined to provide a backdrop of the environment in which the terrorist organizations emerged and now thrive.

Chapter II focuses on Colombia. It offers a brief discussion of the government's internal failures to successfully combat terrorism that became contributing factors for terrorist expansion in Colombia including the facilitation of terrorist funds. A historical perspective on the inception of terrorism in Colombia lays the foundation for examining the economy, financial markets, and banking systems. The historical background also provides the framework for how the Colombian Revolutionary Armed Forces-Popular Army (FARC), the National Liberation Army (ELN), and the United Self-defense Forces of Colombia (AUC) are capable of penetrating the financial markets and banking systems to finance their activities.

Chapter III shifts to the presentation of two additional countries: Peru and Great Britain (Northern Ireland), examining the same factors of financial globalization and free markets explored in Chapter II for Colombia. Each country's case is analyzed individually. First government actions are presented as background. Then, the four key

areas are examined, focusing on the status of the economy, the financial markets and banking system, internal auditing and monitoring, and international cooperation to combat terrorist financing.

Chapter IV concludes the research with a three-country analysis of the similarities, differences, and implications for countering terrorist financing given issues in regime type, financial globalization and free markets from the three countries. Finally, based on the evidence presented, the study offers recommendations for policy actions to better counter terrorist financing.

## **C. LITERATURE REVIEW**

### **1. Terrorism and Democracy**

First, it is important to establish a common definition and the underlying elements of democracy before discussing it as the context for the facilitation of terrorist financing in Colombia, Peru, and Great Britain. Michael Freeman conceptualizes democracy as “the embodiment of the notions of equality, liberty, and the rule of law through the combination of norms, institutions, procedures, and/or outcomes.”<sup>2</sup> Freeman’s definition of democracy fits best in this study and is simplistic enough to illustrate the permissive environment in Colombia, Peru, and Great Britain that was created for terrorists and their financing activities to thrive.

Martha Crenshaw argues that there is a need to make a distinction between direct and facilitating causes of terrorism within democracies.

A comprehensive explanation [of terrorism], however, must also take into account the environment in which terrorism occurs and address the question of whether broad political, social, and economic conditions make terrorism more likely in some contexts than in others.<sup>3</sup>

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<sup>2</sup> Michael Freeman, *Democracy, Al-Qaeda, and the Causes of Terrorism*, *Studies in Conflict and Terrorism*, forthcoming, 2007, 1-37. Michael Freeman is Assistant Professor at the Naval Postgraduate School Defense Analysis Department.

<sup>3</sup> Martha Crenshaw, “The Causes of Terrorism,” *Comparative Politics*, 13(4) (1981): 379-391.

In this study, the approach is similar in terms of looking at terrorist financing in the context of globalization and free markets in a democratic setting. The author does not argue that the government of each case study has directly caused the terrorist actions in their respective countries. Rather the aim is to illustrate how some of governments' actions have facilitated both the existence of the terrorist organizations and their financing activities in their countries. Crenshaw, Leonard Weinberg, Marc Sageman, and others point out that there are gaps in the understanding of terrorist activities and the political and economic environment in which they exist.<sup>4</sup>

Weinberg presents his studies on terrorism and democracy in terms of what he observes to be sources of terrorism in democracies not observed in non-democratic governments. Like Crenshaw, Weinberg acknowledges that each setting is different and generalities across countries can be misleading. However, to disregard generalities given the high level of interdependence and connectivity among countries in the global market would be dangerous and counterproductive in the international setting. Specifically, Patrick Hardouin and Reiner Weichhardt's suggest, "deficiencies in democratic development, a weak state, a lack of civil society, and the absence of sound economic institutions can be fertile bases for terrorist and criminal organizations."<sup>5</sup> Paula Dobriansky points out "terrorists have also found space to operate in democratic states...Democracies, however, have an advantage in their ability to rise to the occasion and implement needed reforms with popular consent."<sup>6</sup> These cases will show where the democratic governments did rise to the occasion as well as where they did not. Consequently, by not effectively countering the terrorist organizations, the democracies facilitated the terrorists' existence and financing capabilities. Studying general trends of

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<sup>4</sup> Martha Crenshaw, "The Causes of Terrorism," *Comparative Politics*, 13(4) (1981): 379-391; Leonard Weinberg, in *The Roots of Terrorism: Democracy and Terrorism*, ed. Louise Richardson, 2006, 45-56; Marc Sageman, *Understanding Terror Networks* (Philadelphia: University of Pennsylvania Press: 2004).

<sup>5</sup> Patrick Hardouin and, Reiner Weichhardt, "Terrorist fund raising through criminal activities. *Journal of Money Laundering Control*," 9(3) (2006): 303-308, in the ABI/INFORM Global database (Document ID: 1091265341) (accessed October 1, 2007), 303.

<sup>6</sup> Paula J. Dobriansky, Henry A. Crumpton, and F. Gregory Gause III, "Tyranny and Terror," *Foreign Affairs*, 85(1) (2006): 135-138, in the ABI/INFORM Global database (Document ID: 979177711) (accessed October 27, 2007).

how terrorists operate and finance their activities across nations, particularly democracies, can be enlightening for international efforts to counter terrorists.

## **2. Terrorist Financing and Globalization**

Atanas Gotchev describes globalization as the phenomenon of development of global production and markets and their social, political, and cultural consequences. He further comments that globalization is widely associated with increased economic integration, international exchange growth, and interdependence.<sup>7</sup> In this study, when discussing the dynamics of globalization as it relates to terrorists financing, the author infers from the wider association of globalization. To make a distinction while examining all three cases, in the previous section, the political aspect of globalization and terrorism was introduced separately.

Vinod Saighal points out what others in the field also acknowledge, “global terrorism cannot be really de-linked from the other dominant global processes that are shaping the world of the twenty-first century.”<sup>8</sup> Dayanath Jayasuriya also suggests the same findings regarding vulnerabilities of securities and futures markets in the global economy. Jayasuriya states, “As developed countries strengthen controls, developing countries that lag behind in implementing control systems will become increasingly vulnerable [to criminal and terrorist exploitation].”<sup>9</sup>

In a September 2003 speech, Canadian Prime Minister Jean Chretien stated, “Government cannot focus only on domestic policy. Good global citizenship is part of governing in the 21st century...The major challenges of the time include poverty, environmental degradation, infectious disease, regional conflicts, organized crime and

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<sup>7</sup> Atanas Gotchev, “The Roots of Terrorism,” *Terrorism and Globalization*, ed. Louise Richardson, 2006, 103-115.

<sup>8</sup> Vinod Saighal, *Dealing With Global Terrorism: The Way Forward* (Elgin, IL: New Dawn Publishing, 2004), 145.

<sup>9</sup> Dayanath Jayasuriya, “Money laundering and terrorism financing: The role of capital market regulators,” *Journal of Financial Crime*, 10(1) (2002): 30-36, in the ABI/INFORM Global database. (Document ID: 154647481) (accessed June 10, 2008), 32.

terrorism.”<sup>10</sup> In today’s global environment, countries alone cannot deal with terrorism and terrorist financing by themselves. A concerted effort is critical in denying terrorist their livelihood in both the short-term and long-term. When speaking about NATO’s role in the international fight against terrorism, Hardoiun and Weichhardt echo the same sentiment, “A successful international effort to confront terrorism requires a multi-faceted strategy that draws on strengths and unique assets of many international organizations.”<sup>11</sup>

Ted Gurr points out that structured inequalities within countries “are breeding grounds for violent political movements in general and specifically terrorism...The growth of inequalities across the interdependent global system has similar consequences.”<sup>12</sup> Some of the unintended consequences of globalization have in many instances “led to pronounced income disparities between the smallest percentages of people in the highest income brackets and those at the lower ends of the spectrum.”<sup>13</sup> Looking at terrorist financing activities, interdependent global systems also facilitate terrorist activities. Atanas Gotchev reinforces Gurr’s findings and suggests that although “according to advocates of globalization, interdependence should result in a dynamic and constantly modernizing world of prosperous nations,” in reality what is observed is the realization of an “uneven development and inequitable distribution...across countries.”<sup>14</sup> In terms of terrorist financing and these adverse affects of globalization, Gotchev further suggests that the gaps created in conflict areas provide fertile ground for terrorists to engage in illicit activities such as the smuggling of drugs, weapons, consumer goods, and

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<sup>10</sup> Jean Chretien, “Emphasis on Good Global Citizenship,” *Presidents & Prime Ministers*, 12(5), (September 2003): 18-19 in the ABI/INFORM Global database (Document ID: 524504021) (accessed October 27, 2007).

<sup>11</sup> Patrick Hardouin and Reiner Weichhardt, “Terrorist fund raising through criminal activities,” *Journal of Money Laundering Control*, 9(3) (2006): 303-308 in the ABI/INFORM Global database (Document ID: 1091265341) (accessed October 1, 2007).

<sup>12</sup> Ted Robert Gurr, *The Roots of Terrorism: Economic Factors*, ed. Louise Richardson, (Club de Madrid, 2006) 90.

<sup>13</sup> Vinod Saighal, *Dealing With Global Terrorism: The Way Forward* (Elgin, IL: New Dawn Publishing, 2004), 145-146.

<sup>14</sup> Atanas Gotchev, “Terrorism and Globalization,” *The Roots of Terrorism*, ed. Louise Richardson, (New York: Routledge, 2006), 105.

other items. This last point is specifically relevant to the discussion of the Colombian, Peruvian, and British terrorist organizations in this study since all have been identified as primarily financing their activities through drugs and weapons' smuggling.<sup>15</sup>

### **3. International Efforts to Counter Terrorist Financing**

"The linkage between terrorism and crime is mainly a functional one...terrorist movements frequently engage in criminal activity to finance their activities relying on robbery; kidnapping for ransom; extortion; and trafficking in drugs, scarce commodities, or consumer goods."<sup>16</sup> Just as criminal elements have gotten more sophisticated operating at a transnational level, so too have terrorist organizations. Consequently, it is no surprise that the international legislation for dealing with terrorist financing has its inception in measures to counter economic crime and money laundering.

The international organization charged with developing the recommendations for nations to confront the problems of economic crime and money laundering was the Financial Action Task Force (FATF). The FATF, an independent, intergovernmental policy-making body, was established in 1989 by the G7 Summit in Paris due to the growing concerns about the threat posed by money laundering to the international banking system.<sup>17</sup> The FATF issued Forty Recommendations towards this purpose in 1990. "In the aftermath of the September 11 terrorist attacks in the United States and the discovery of the wide geographic extent of the terrorist financial infrastructure that enabled them, governments moved quickly to create new counter-measures that could be

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<sup>15</sup> Rachel Ehrenfeld, *Funding Evil*, (Chicago: Bonus Books, 2003); Ted Robert Gurr, *The Roots of Terrorism: Economic Factors*, ed. Louise Richardson, (Club de Madrid, 2006).

<sup>16</sup> Ted Robert Gurr, *The Roots of Terrorism: Economic Factors*, ed. Louise Richardson, (Club de Madrid, 2006), 94.

<sup>17</sup> Andrew Parkin, "G-7 Summit 1997," *Center for the Study of Democracy*, 1997, [http://www.fpiif.org/briefs/vol2/v2n36g7\\_body.html](http://www.fpiif.org/briefs/vol2/v2n36g7_body.html) (accessed on August 25, 2008). "The G-7 was formed in 1975 to provide an informal forum for coordination of economic policy among leaders of prominent industrialized nations. Since 1975 the agenda and scope of the G-7 has steadily expanded under pressures of continuing economic and political crises. The G-7 directly influences international financial and trade institutions by virtue of its disproportionate economic power. The G-7, composed of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States."; James Jackson, "CRS Report for Congress: The Financial Action Task Force-An Overview," *Congressional Research Service*, Order Code RS21904, Updated March 4, 2005.



specifically used to detect and dismantle such structures.”<sup>18</sup> Post 9/11, the FATF refocused its efforts towards terrorist financing and issued an additional Nine Special Recommendations on Terrorist financing.<sup>19</sup> Table 1 depicts the FATF Special Recommendations and a brief synopsis of what each country is expected to do. However, it is important to note that the FATF does not have any enforcement capability; what the FATF can do is suspend those member countries that do not comply with the guidelines in a timely manner.<sup>20</sup>

Table 1. FATF Nine Special Recommendations<sup>21</sup>

<b><i>Recommendation &amp; Short Title</i></b>	<b><i>Description of the Requirement</i></b>
1: Ratification and implementation of UN instruments	As early as 1988, the UN passed a treaty to address money laundering and later a treaty was passed on drug smuggling. Subsequent treaties also addressed counter money laundering efforts that countries agreed to ratify. Special Recommendation 1 calls for countries to adhere to ratification and implementation of all such treaties.
2: Criminalize terrorist activities, organizations, and financing	Each country would have criminalize terrorist financing, and terrorist acts and organizations. Further, such offenses should be designated money laundering predicate offenses.
3: Freezing and confiscating terrorist assets	Each country would have to draft and pass appropriate legislation that would allow the freezing and confiscating terrorist assets. This would entail the sharing and passing of information between nation specific institutions as well as international.
4: International cooperation	Countries are to cooperate with other nations with regard to all matters related to terrorism and terrorist financing. This includes criminal and civil enforcement, administrative investigations, inquiries and proceedings.
5: Alternative remittance	Persons or entities engaged in formal or informal systems (e.g., hawala) of transferring funds ought to be bound by the same oversight as the banking sector.

<sup>18</sup> FATF, “Report on Money Laundering Typologies 2001-2002,” *Financial Action Task Force on Money Laundering*, February 1, 2002.

<sup>19</sup> James Jackson, “CRS Report for Congress: The Financial Action Task Force- An Overview,” *Congressional Research Service*, Order Code RS21904, Updated March 4, 2005.

<sup>20</sup> Ibid.

<sup>21</sup> Data on this table are derived from multiple sources: Dayanath Jayasuriya, “Money laundering and terrorism financing: The role of capital market regulators,” *Journal of Financial Crime*, 10(1) (2002): 30-36 in the ABI/INFORM Global database (Document ID: 154647481) (accessed June 10, 2008); James Jackson, “CRS Report for Congress: The Financial Action Task Force-An Overview,” *Congressional Research Service*, Order Code RS21904, Updated March 4, 2005; Jackie Johnson, “Is the global financial system AML/CFT prepared?” *Journal of Financial Crime*, 15(1) (2008): 7-21, in the ABI/INFORM Global database (Document ID: 1440894781) (accessed June 10, 2008); Jackie Johnson (2008); FATF, “Report on Money Laundering Typologies 2001-2002,” *Financial Action Task Force on Money Laundering*, February 1, 2002.

<b><i>Recommendation &amp; Short Title</i></b>	<b><i>Description of the Requirement</i></b>
6: Wire transfers	Each country should strengthen customer identification requirements on wire transfers.
7: Non-profit organizations	Countries should ensure that non-profit organizations do not remain vulnerable to the use by terrorists to launder funds.
8: Cross border transportation of currency	Each country should emplace a mechanism or control system to record and detect cross-border transportation of currency and bearer instruments.

Although the FATF Nine Special Recommendations appear straightforward, they are all subject to the interpretation of each participating country. A single agreed upon definition of terrorism or what constitutes a terrorist globally does not exist. Nations across the globe do not have access to the same level of resources and technology to implement these recommendations effectively. In some instances the legislative process is filled with red tape and bureaucracy that an agreed upon strategy could take years to implement. So what has happened with the international community's efforts to combat terrorist financing seven years post 9/11 with respect to implementing the FATF Forty plus Nine Special Recommendations? James Jackson, Jackie Johnson, Jean-François Thony and Cheong-Ann Png seem to indicate that the implementation is slow, and the degree to which it has occurred varies.<sup>22</sup> Johnson, Thony and Png found more countries complied with the implementation of the FATF Forty Recommendations than with the FATF Nine Special Recommendations.<sup>23</sup>

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<sup>22</sup> James Jackson, "CRS Report for Congress: The Financial Action Task Force- An Overview," *Congressional Research Service*, Order Code RS21904, Updated March 4, 2005, 2005. Johnson, "Is the global financial system AML/CFT prepared?, *Journal of Financial Crime*, 15(1) (2008): 7-21 in the ABI/INFORM Global database (Document ID: 1440894781) (accessed June 10, 2008); Jackie Johnson (2008). Third round FATF mutual evaluations indicate declining compliance from *the Journal of Money Laundering Control*, 11(1), 47-66 in the ABI/INFORM Global database (Document ID: 1440896701) (accessed June 10, 2008); Jean-François Thony, Cheong-Ann Png, FATF, "Special Recommendations and UN Resolutions on the financing of terrorism: A review of the status of implementation and legal challenges faced by countries," *Journal of Financial Crime*, 14(2) 2007: 150, in the ABI/INFORM Global database (Document ID: 1344349811) (accessed June 10, 2008).

<sup>23</sup> Jackie Johnson, "Is the global financial system AML/CFT prepared?" *Journal of Financial Crime*, 15(1) (2008): 7-21, in the ABI/INFORM Global database (Document ID: 1440894781) (accessed June 10, 2008); Jackie Johnson, "Third round FATF mutual evaluations indicate declining compliance," *Journal of Money Laundering Control*, 11(1) (2008): 47-66, in the ABI/INFORM Global database (Document ID: 1440896701) (accessed June 10, 2008); Jean-François Thony and Cheong-Ann Png, FATF. "Special Recommendations and UN Resolutions on the financing of terrorism: A review of the status of implementation and legal challenges faced by countries," *Journal of Financial Crime*, 14(2) (2007): 150, in the ABI/INFORM Global database (Document ID: 1344349811) (accessed June 10, 2008).

Part of the problem with the international community's efforts to counter terrorist financing is, as Hardoiun and Weichhardt point out, "financial flows linked to terrorist actions are often very low and remain below the thresholds of financial control mechanisms."<sup>24</sup> Robert Vella-Baldacchino and Antonello Biagioli illustrate the complexity required to effectively implement security measures to monitor and report suspicious activity, particularly money laundering that may be funding terrorism.<sup>25</sup> Consequently, in Baldacchino and Biagioli's illustration they also shed light on some of the reasons why the international community has such low compliance levels implementing the FATF Forty plus Nine Special Recommendations. Biagioli points out that much of the problems with the implementation of counter-measures lie in countries simply taking a reactive approach using traditional methods. He implies countries must be much more creative and innovative. Biagioli further proposes that countries must move toward anticipating criminal or terrorist actions and prevent their financing activities through the collection and sharing of information.<sup>26</sup> In his study of the Malta Exchange, Baldacchino found the level of cooperation between the financial establishments and the specialized financial intelligence unit allowed the Malta authorities to quickly identify, detain, and prosecute economic criminals.<sup>27</sup> Due to the inequality in capability across countries to implement a system of gathering or sharing information, terrorists can continue to exploit the financial systems to move money as well as make money. Terrorists and criminals are familiar with the monitoring and

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<sup>24</sup> Patrick Hardouin and Reiner Weichhardt. "Terrorist fund raising through criminal activities," *Journal of Money Laundering Control*, 9(3) (2006): 303-308, in the ABI/INFORM Global database (Document ID: 1091265341) (accessed October 1, 2007).

<sup>25</sup> Robert Vella-Baldacchino, "Overview of a securities market strategy to prevent money laundering and terrorist financing: The Malta Stock Exchange's experience," *Journal of Money Laundering Control*, 9(3) (2006): 322-326, in the ABI/INFORM Global database (Document ID: 1091265371) (accessed October 1, 2007); Antonello Biagioli, "Methodological innovation and effective action: Looking into synergies to countering economic crime," *Journal of Financial Crime*, 13(3) (2006): 369 in the ABI/INFORM Global database (Document ID: 1073500451) (accessed October 1, 2007).

<sup>26</sup> Antonello Biagioli, "Methodological innovation and effective action: Looking into synergies to countering economic crime," *Journal of Financial Crime*, 13(3) (2006): 369, in the ABI/INFORM Global database (Document ID: 1073500451) (accessed October 1, 2007).

<sup>27</sup> Robert Vella-Baldacchino, "Overview of a securities market strategy to prevent money laundering and terrorist financing: The Malta Stock Exchange's experience," *Journal of Money Laundering Control*, 9(3) (2006): 322-326, in the ABI/INFORM Global database (Document ID: 1091265371) (accessed October 1, 2007).

monetary thresholds. Through globalization as countries become more integrated and interdependent, terrorists will quickly adapt and exploit financial institutions or companies with weak control systems. Some of these examples will be evident in the case studies of Colombia, Peru, and Great Britain in the following chapters of this study.

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## II. COLOMBIA'S CASE

### A. BACKGROUND

Colombia's problematic democratic history began shortly after the country's revolution against Spanish rule when it was part of Spain's New Granada colony (Colombia, Venezuela, Panama, and Ecuador).<sup>28</sup> From the time of its independence, two political parties have historically dominated Colombian politics: the Liberal and Conservative parties. The Liberal party "believed in a decentralized government, strong regional power, and a less influential role for the church,"<sup>29</sup> while the Conservative party "believed in a strong central government and a powerful church."<sup>30</sup> On multiple occasions, the disparities between these two parties have divided the country and shaped Colombia's violent history, including the creation of the FARC, ELN, and AUC.

Of significance to the country's present status and its war against drugs and terrorism is the period from 1946 to 1958 known as "La Violencia" which is said to have claimed hundreds of thousands of lives.<sup>31</sup> In addition to the civil uprising and banditry that engulfed the country, this period was also marked with military repression. In 1958, to end the violence and turn the economy around, the two political parties formed a coalition known as the National Front.<sup>32</sup> Unfortunately, the period of the National Front became characterized as repressive, limiting democratic liberties, and holding the country

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<sup>28</sup> New Granada achieved its independence in 1824 and became known as the Republic of Greater Colombia. In 1830, Ecuador and Venezuela separated. In 1903, Panama declared its independence from Colombia. This information was derived from the History of Colombia, <http://www.infoplease.com/ipa/A0107419.html> (accessed November 20, 2007).

<sup>29</sup> History of Colombia, <http://www.infoplease.com/ipa/A0107419.html> (accessed November 20, 2007).

<sup>30</sup> Ibid.

<sup>31</sup> Peter DeShazo and Tanya Primiani, Phillip McLean, "Back From the Brink: Evaluating Progress in Colombia, 1999-2007," *CSIS Report, A Report of the Americas Center for Strategic and International Studies*, November 2007.

<sup>32</sup> Under the National Front the presidency would alternate between a Liberal and a Conservative candidate every term for sixteen years (later extended to twenty-four years) without allowing entry by any other political entity.

under siege by using the military to control any opposition to the government.<sup>33</sup> Additionally although every Colombian citizen had a vote in the country's political process, the rich landowners often threatened and coerced the peasants to vote, as they desired, further delegitimizing the democratic process. Consequently, the FARC and the ELN emerged in the 1960s as rural based movements with Marxist ideologies, which were opposed to the repressive National Front government.

The FARC, founded in 1964, dedicated its movement to rural insurgency through the early 1980s, and it progressively became highly involved in illicit drug trade filling the vacuum left by the drug cartels.<sup>34</sup> The ELN was also founded in 1964 but it had a "strong religious influence [and a] doctrine for insurrection inspired by the Cuban revolution."<sup>35</sup> The religious influence dissuaded, for a while, the ELN from becoming involved in the illicit drug trade. Eventually, however, they too became highly involved in the highly profitable drug trafficking.

Also during the 1960s, because of the Colombian government's inability to provide security to the rural parts of the country, landowners and local communities formed "self-defense" groups, the predecessors to the AUC, to counter the FARC and ELN. In 1968, the Colombian government passed Law 48 establishing the right of civilian self-defense militias to protect lives and property, which helped to create and legitimize the predecessors of the present day AUC.

The government of Colombia would spend the next forty years fighting these Marxist guerilla groups as well as the right wing paramilitary groups it allowed to exist, and in some cases, helped to create. Today, the FARC, ELN, and AUC are on the U.S. State Department's terrorist list. The strongest of the three remains the FARC, while the

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<sup>33</sup> Colombian Human Rights, Network Timeline of Colombian Recent History, (2007), <http://colhrnet.igc.org/timeline.htm>, (accessed December 12, 2007).

<sup>34</sup> Peter DeShazo, Tanya Primiani and Phillip McLean, "Back From the Brink: Evaluating Progress in Colombia, 1999-2007," *CSIS Report. A Report of the Americas Center for Strategic and International Studies*, November 2007.

<sup>35</sup> A.K. Williams and Celso Andrade, *International Terrorism Presentation: National Liberation Army Brief*, Fall Quarter 2007, International Terrorism Course, Presented November 5, 2007 (Monterey, CA: Naval Postgraduate School, 2007).

majority of the AUC has demobilized. The FARC finances its activities through full range of drug trafficking, including taxation, cultivation, and distribution. Other FARC financing methods identified are kidnapping, extortion, and hijacking.<sup>36</sup> The ELN remains active but weak; it finances its activities through taxation of the illegal narcotics industry as well as through kidnappings, hijackings, and extortion.<sup>37</sup> In 2007, the Colombian government determined that the AUC no longer exists. However, the Colombian government estimates that 22 new criminal groups emerged from AUC members that refused to demobilize.<sup>38</sup> These new AUC derivatives engage in criminal activity and seek to exploit the illicit drug market in Colombia.

## **B. THE ECONOMY**

Colombia ranks among the most progressive, industrializing countries in the world and has a diverse economy. “[Colombia] has a broad, rich resource base, skilled human resources, a modernizing manufacturing and consumer economy, a legal, regulatory, business and physical infrastructure conducive to productive business activity, and a long history of economic growth.”<sup>39</sup>

Starting in 1991, under President Gaviria’s administration, Colombia’s economic liberalization opened the country’s economy to international trade and capital investments by non-Colombians. The economic liberalization entailed significant reductions in tariff duties, eliminating non-tariff barriers, actively negotiating free trade agreements, and reforming foreign exchange and tax legislation, labor regulations and the foreign investment regime. During the first six months of 2007, Foreign Direct Investment (FDI) grew to \$4 billion, which was three times the amount invested during

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<sup>36</sup> United States State Department, “Country Reports on Terrorism 2007,” (2007), <http://www.state.gov/s/ct/rls/crt/2007/> (accessed August 2008).

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

<sup>39</sup> United States Embassy Bogota, *U.S. Department of State FY 2001 Country Commercial Guide: Colombia*, (2000), <http://www.state.gov> (accessed May 20, 2008).



the same period in 2006. The United States, Spain, and Brazil are the leading sources of FDI in Colombia. Colombia's gross domestic product (GDP) grew 6.8 percent in 2006 and nearly 7 percent in the second quarter of 2007.<sup>40</sup>

Poverty reduction has not been as successful, but there has been progress. In 2006, an estimated 45 percent of the population lived below the poverty line. This was down from nearly 49.2 percent in 2005 and much improved from 60 percent in 2000.<sup>41</sup> The Colombian government has invested millions of dollars on social programs throughout the country to combat and reduce poverty. The programs provide subsidies, monetary support, as well as social, environmental, and/or productive technical assistance so that families can improve their income and become more involved in society.

The Colombian currency is the peso (COP), which has been free floating since 1997 in an effort to target and control inflation.<sup>42</sup> As of June 5, 2008, the exchange rate of COP to the US dollar was COP1,840/US\$1<sup>43</sup> while historical exchange rates are illustrated in Table 2. Note that the COP has strengthened relative to the U.S. dollar. This potentially provides an advantage in trade and investing to grow consumption in Colombia. However, since the U.S. is one of the leading FDI in Colombia, there may potentially be a slow down in exports.

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<sup>40</sup> Colleen W. Cook, "Colombia: Issues for Congress," November 19, 2007, (2007), [http://www.colombiaemb.org/docs/Reporte\\_de\\_Colombia\\_Congreso\\_US\\_2007.pdf](http://www.colombiaemb.org/docs/Reporte_de_Colombia_Congreso_US_2007.pdf) (accessed June 5, 2008).

<sup>41</sup> Central Intelligence Agency, *CIA World Fact Book: Colombia*, May 15, 2008, (2008), <https://www.cia.gov/library/publications/the-world-factbook/geos/co.html#Econ> (accessed June 5, 2008).

<sup>42</sup> Andrew Berg, Monetary Regime Options for Latin America, Finance and Development, September 2003, in the BOSUN database (accessed June 5, 2008), 24-27.

<sup>43</sup> "United States foreign exchange rate in Colombian pesos," (June 5, 2008), [http://finance.google.com/finance?q=\\$COP](http://finance.google.com/finance?q=$COP) (accessed June 5, 2008).

Table 2. Historical Colombian Peso to U.S. Dollar Exchange Rates<sup>44</sup>

<i>Year</i>	<i>COP/US\$1</i>
2003	2,877.6
2004	2,628.6
2005	2,320.7
2006	2,358.6
2007	2,013.8

### C. THE FINANCIAL MARKETS AND BANKING SYSTEM

The Colombian Securities Market is small, but it has enjoyed high growth in recent years. Only the largest of Colombia's companies participate in the local stock or bond markets. The majority of companies meet their financing needs through the banking system, by reinvesting their profits, and through suppliers' credit. Public demand for securities is generally low due to a combination of Colombians' low personal savings and investment rates. Institutional investors, particularly the private pension funds that mobilize the largest share of national savings, concentrate their holdings in government paper and AAA-rated commercial paper, a rating given to only a handful of companies. The Colombian Securities Commission and Exchange oversees the stock exchange, regulates market intermediaries, broker's fees, and the financial disclosure of listed companies. Colombia's judicial system defines the legal rights of commercial entities, reviews regulatory enforcement procedures and adjudicates contract disputes in the business community.

Over the last few years, the securities market has traded fewer stocks and more bonds and fixed income securities.<sup>45</sup> In 2003, Colombia's Stock Exchange registered

<sup>44</sup> Central Intelligence Agency, *CIA World Fact Book: Colombia*, May 15, 2008, (2008), <https://www.cia.gov/library/publications/the-world-factbook/geos/co.html#Econ> (accessed June 5, 2008).

<sup>45</sup> United States State Department, "2006 INVESTMENT CLIMATE STATEMENT – Colombia," (2006), <http://www.state.gov/e/eeb/ifd/2006/62320.htm> (accessed May 22, 2008).

marked dynamism, mainly due to economic growth, with record annual GDP growth of 4.3%,<sup>46</sup> and the appreciation of the Colombian peso. The government of Colombia has incentivized foreign investment through a multitude of laws and decrees, which allow flexibility for growth and development.<sup>47</sup> Colombia imposes the same investment restrictions on foreign investors that it does on national investors. All investors must obtain a license from the Commission of Companies and register with the local Chamber of Commerce. Foreign investments must register with the Central Bank's foreign exchange office within three months of the transaction date to ensure repatriation of profits and remittances and to access official foreign exchange.

Liberalization of Colombia's financial service industry in the early 1990s permitted 100 percent foreign ownership of financial institutions. However, the Colombian Banking Superintendence must approve all foreign direct investment of ten percent or more in a Colombian financial entity. Likewise, the Banking Superintendence must provide authorization to portfolio investments in the financial sector through foreign investment funds that plan to acquire equity participation of five percent or more. The use of foreign personnel in financial institutions is limited to administrators, legal representatives, and technicians.

In 2005, Colombia consolidated supervision of the banking and securities sectors under the Financial Superintendence. Bank and other financial institution operations are limited through legislation that requires separation of fiduciary, investment banking, commercial loans, leasing, and insurance services, from banking services. Banking institutions may develop all these different activities in the same office or building, but must have separate management at the heads of these services.<sup>48</sup>

A tax on financial transactions is applied to all withdrawals from checking and savings accounts, including accounts with the Central Bank. Withdrawals from savings

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<sup>46</sup> "Indicators, The Economist U.S. Edition," *The Economist*, March 6, 2004, in the Nexis® database (accessed July 21, 2008).

<sup>47</sup> United States State Department, "2006 Investment Climate Statement – Colombia," (2006) <http://www.state.gov/e/eeb/ifd/2006/62320.htm> (accessed May 22, 2008).

<sup>48</sup> Ibid.

accounts for the purchase of low-income housing, transactions on the inter-bank market, and the sale or purchase of foreign currency are exempt from the tax. Electronic securities transactions, including stock market transactions, are also exempt from the tax.<sup>49</sup>

The estimated total assets of the country's main banks as of 2007 were approximately \$194 billion and foreign-owned banks controlled 20 percent of the sector assets. Past-due loans accounted for 3.3 percent of the total banking portfolio while the banks' return on equity was 19.5 percent. The financial system registered profits of approximately \$4.3 billion from January to November 2007.<sup>50</sup>

#### **D. INTERNAL AUDITING AND MONITORING**

Financial markets in Colombia and particularly corporations are subject to the rules and auditing procedures of the Securities Commission and Exchange. Similarly, the financial institutions are subject to monitoring and auditing by the Banking Superintendence. The Statute of the Financial System, Decree-Law 663 of 1993, outlines all the specific information that financial institutions must collect from clients and the penalties for non-compliance.<sup>51</sup> The data required are extensive and may well serve as a strong deterrent for misuse of the system.

The Banking Superintendence performs its control function through the analysis of the information provided by the financial institutions under its control and supervision, as well as through annual visits. In addition to the controls placed by the Banking Superintendence, the rules on money laundering prevention and detection among banking institutions are also subject to a triple control through a Compliance Officer, Internal Auditor and External Auditor of each institution.<sup>52</sup> Further, the Banking Superintendent,

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<sup>49</sup> United States State Department, "2006 Investment Climate Statement – Colombia," (2006), <http://www.state.gov/e/eeb/ifd/2006/62320.htm> (accessed May 22, 2008).

<sup>50</sup> Ibid.

<sup>51</sup> Asobancaria, "IRS Requirements to Rate the Colombian "Know Your Client" Policy," *Colombian Asobancaria*, (2001), [www.asobancaria.com/upload/docs/docPub2609\\_1.doc](http://www.asobancaria.com/upload/docs/docPub2609_1.doc) (accessed June 3, 2008).

<sup>52</sup> Ibid.

through the “know your client” policy, requires banks to keep documentation of owner identity and origin of funds for cash transactions that meet the criteria illustrated in Figure 1.

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|---|
| <ol style="list-style-type: none"><li>1) Transactions above US\$10,000 or COP10,000,000</li><li>2) Transactions of US\$750 or its equivalent in other currencies if through money exchange bureaus</li><li>3) Transactions of US\$500 or its equivalent in other currencies if through special or borderline money exchange bureaus</li></ol> |
|---|

Figure 1. Colombian Bank Criteria for Retaining Owner Identity<sup>53</sup>

## E. INTERNATIONAL COOPERATION

Colombia is one of the four nations worldwide participating as a pilot country in the G8 anti-corruption and transparency initiative.<sup>54</sup> Colombia is also a member of the Financial Action Task Force of South America Against Money Laundering (GAFISUD), created in Cartagena Colombia on December 8, 2000.<sup>55</sup> GAFISUD’s purpose is to work toward developing and implementing a comprehensive global strategy to combat money laundering and terrorist financing. GAFISUD carries this charter as outlined by the Financial Action Task Force on Money Laundering (FATF) Forty Recommendations and FATF Nine Special Recommendations.<sup>56</sup> Based on a recent study of the level of

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<sup>53</sup> Data for Figure 1 were derived from Asobancaria (2001). Asobancaria, “IRS Requirements to Rate the Colombian “Know Your Client” Policy,” *Colombian Asobancaria*, (2001), [www.asobancaria.com/upload/docs/docPub2609\\_1.doc](http://www.asobancaria.com/upload/docs/docPub2609_1.doc) (accessed on June 3, 2008).

<sup>54</sup> The G8 Group is an unofficial forum of the heads of the leading industrialized democracies (Russia, the U.S., Britain, France, Japan, Germany, Canada and Italy), where the European Commission is also represented and fully participates. This forum was designed to harmonize attitudes to acute international problems. The member states account for 49% of global exports, 51% of industrial output, and 49% of assets in the International Monetary Fund, <http://en.g8russia.ru/g8/history/shortinfo/>, (accessed on July 16, 2008).

<sup>55</sup> Organization for Economic Co-Operation and Developed (OECD), [http://www.oecd.org/document/44/0,3343,en\\_32250379\\_32236869\\_34355875\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/44/0,3343,en_32250379_32236869_34355875_1_1_1_1,00.html) (accessed July 16, 2008). GAFISUD was created on December 8, 2000 in Cartagena, Colombia by means of a memorandum of understanding by representatives of the governments of nine South American countries.

<sup>56</sup> James Jackson, “CRS Report for Congress: The Financial Action Task Force- An Overview,” *Congressional Research Service*, Order Code RS21904, Updated March 4, 2005.

compliance with implementation of the FATF Forty plus Nine Special Recommendations between FATF members and non-members, Colombia was listed at 63 percent compliance and 17 percent compliance, respectively.<sup>57</sup> Of note, in close cooperation with the U.S., Colombia has provided its Specially Designated Nationals List and the U.S. Treasury Department through the Office of Foreign Assets Control pursued and blocked the assets of narcotics traffickers and terrorists.<sup>58</sup>

## **F. ANALYSIS**

The early elitist Colombian society ensured that the governing power and wealth remained in their hands under the guise of the democratic political two-party system where only the elite benefited. By creating this imbalance of power, the elite ensured that the poor peasant class felt they would not have a voice or political stance in the absence of a radical change. This ideology for radical change manifested itself in the formation of groups such as the FARC, the ELN, as well as other left-wing groups.<sup>59</sup> Additionally, the rule of law and the government were weak. To exacerbate the lack of or diminished rule of law in rural areas, the numerous corrupt politicians, law enforcement personnel, and military leaders undermined the democratic political process. The most recent case is the “para-politics scandal” where ex-AUC commanders and collaborators in prison implicated numerous government officials ranging from police, military leaders, politicians, to judges in collaborating with the paramilitaries.<sup>60</sup> All these shortcomings in equality, liberty, and the rule of law created the landscape for the FARC, ELN and AUC to prosper.

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<sup>57</sup> Jackie Johnson, “Is the global financial system AML/CFT prepared?” *Journal of Financial Crime*, 15(1) (2008): 7-21, in the ABI/INFORM Global database (Document ID: 1440894781) (accessed June 10, 2008).

<sup>58</sup> United States State Department, “Country Reports on Terrorism 2007,” (2007), <http://www.state.gov/s/ct/rls/crt/2007/103710.htm> (accessed August 2008).

<sup>59</sup> David Rapoport, “The Four Waves of Modern Terrorism,” in Audrey Kurth Cronin and James Ludes, eds., *Attacking Terrorism*, 46-73.

<sup>60</sup> Juan Forero, “Colombian Unravels Government-Paramilitary Ties Imprisoned Ex-Official Is Central Witness in Scandal Shaking U.S. Ally,” *The Washington Post*, March 20, 2007, DC Edition: F Section: A Section, A16.

Colombia's economy is thriving, and although culturally the general population is not keen on investing or saving, the returns in the financial systems provide a lucrative venue to raise funds for those willing to take the risks. The FARC, ELN, and AUC may engage in raising their finances by purchasing stocks going through an intermediary broker or corporation to ensure the activity appears legitimate. In addition, if not to just raise funds, this may also prove an effective way to launder money from their illicit drug activities.

Typically, bank-to-bank transactions are not questioned due to the presumed compliance with the regulations and laws within banks in Colombia, and therefore, are exploitable. A potential exploitable limitation in the banking sector is the "know your client" criteria shown in Figure 1. The FARC, ELN, or AUC can readily have numerous intermediaries open and operate bank accounts. With these multiple bank accounts, the FARC, ELN, or AUC can perform cash transactions within the thresholds depicted in Figure 1. All such cash transactions would serve as an easy and undetectable way to launder money brought into the country illegally. Another exploitable vulnerability of the banking sector is the lack of enforcement of the Statute of the Financial System, Decree-Law 663 of 1993.<sup>61</sup> The law serves as sustainable internal control as long as those at helm responsible for the enforcement actually abide by the law. The key element for terrorists to take advantage of the Colombian financial infrastructure to launder, transfer, and invest their funds is to incentivize (bribe) personnel within the control systems to allow them entry.

The number of foreign owned banks in Colombia provides the FARC, ELN, and AUC the gateway to their international financing activities (i.e., remittance of illicit funds from the exportation of drugs worldwide). As technology advances, and the interconnectivity amongst financial institutions worldwide grow, the FARC, ELN, and AUC will be able to move and control funds around the world through a couple of key strokes via the internet.

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<sup>61</sup> Asobancaria, "IRS Requirements to Rate the Colombian "Know Your Client" Policy," *Colombian Asobancaria*, (2001), [www.asobancaria.com/upload/docs/docPub2609\\_1.doc](http://www.asobancaria.com/upload/docs/docPub2609_1.doc) (accessed on June 3, 2008).

The purchase of foreign currency is also a very likely tactic especially for the FARC and ELN to launder drug money smuggled into the country. The illicit cash can be dispersed amongst several, presumably reputable, individuals or corporations so that they may legitimately purchase the foreign currency and effectively launder the money. An added bonus of buying any foreign currency is that it is exempt from taxes so potentially less money is lost in transaction costs.

In those parts of the country where the terrorists have control, they will continue to raise funds through the normal modes of extortion, kidnapping, smuggling, illegal drug production and trafficking, and through legitimate businesses, which have the added advantage of avoiding taxes. A thriving investment rich Colombia provides the opportunity for legitimate business to grow and expand internationally. As legitimate business expand and grow so does the opportunity exploitation by the FARC, ELN, and AUC. An example of great proportions was the extortion of banana exporters, presumably over \$7.1 million in the span of seven years.<sup>62</sup>

The continued risk for the Colombian government in the terrorist capability to sustain the fight lies in the high percentage of the population living in poverty.<sup>63</sup> As the country continues to prosper economically, the divide between the poor and the remaining 55 percent of the population is not narrowed down, Colombia may well see the negative effects of globalization magnified.<sup>64</sup> As Gotchev suggests, although there is no conclusive evidence that poverty and inequality are directly linked to terrorism, there is evidence that economic deprivation gives rise to demands for political change. In some cases, interested groups seeking the political change resort to terrorism to achieve their goals. Elements of the FARC, AUC, and ELN have resorted to terrorism by taking advantage of the existing inequalities in the past, and currently, the socioeconomic

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<sup>62</sup> EFE News Service, "Colombian Militias May Have Received Over \$7 mn from Growers," *EFE News Service*, Bogota Colombia, February 6, 2007, from the Global NewsBank online (2008), <http://infoweb.newsbank.com> (accessed August 2007).

<sup>63</sup> Central Intelligence Agency, *CIA World Fact Book: Colombia*, May 15, 2008, (2008), <https://www.cia.gov/library/publications/the-world-factbook/geos/co.html#Econ> (accessed June 5, 2008). According to the CIA in 2006, 45 percent of the population lived in poverty or below the poverty line in Colombia.

<sup>64</sup> Atanas Gotchev, "The Roots of Terrorism," *Terrorism and Globalization*, ed. Louise Richardson, 2006, 103-115.



environment in Colombia continues to lend itself for them to continue to operate. The FARC, ELN, or AUC may incentivize the poor to become intermediaries for the terrorists' money laundering activities. These willing recruits needing to provide for their families can establish bank accounts through which small amounts of unlawful money can enter virtually undetected through international remittance. They can lend themselves to be the legitimate figureheads of fictitious enterprises or even legitimate businesses whose licit purpose is to launder money. They may lend themselves to be the "mules" that transport the unlawful money for currency conversion.<sup>65</sup>

A potential negative effect on FARC, ELN, and AUC current financing activities is the weakening of the U.S. dollar relative to the COP. Terrorists, particularly the FARC and ELN, may see their capacity of direct exportation of drugs to the U.S. diminish if exportation of legitimate goods has a significant drop. Given that simulated export of agricultural products is one of many methods that illegal goods and drugs are smuggled out of the country, the FARC and ELN may see their finances decrease.<sup>66</sup> Another hazard for the FARC and ELN financing activities from the drop of the exchange rate is their capability to exploit the black market peso exchange or the international foreign exchange arbitrage. Under the scenario of a weak U.S. dollar, the cost of doing business abroad for the FARC and ELN will likely increase.<sup>67</sup> If the U.S. dollar is weak, that equates to less revenue for them in terms of the amount of COP they can get for their drug in U.S. dollars.

The good news is that although the FARC and elements of the AUC and ELN continue to operate in Colombia, the current government is making it harder for them to survive. Through legislation and implementation of reforms that meet the FATF Forty plus Nine Special Recommendations, the Colombian government has cut off some of the FARC, AUC, and ELN's avenues for financial resources.

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<sup>65</sup> GAFISUD, "Regional Typologies – GAFISUD 2005," (2005), <http://www.gafisud.org/tipologias.asp?idseccion=8>. (accessed August 13, 2008).

<sup>66</sup> Ibid. An example of how simulated exports of agricultural goods is as follows: fake fruits are strategically placed intermixed within a shipment of real fruit and they are exported from one country to the U.S. undetected.

<sup>67</sup> GAFISUD, "Regional Typologies – GAFISUD 2005," (2005), <http://www.gafisud.org/tipologias.asp?idseccion=8> (accessed August 13, 2008).

### **III. ANALYSIS OF TWO ADDITIONAL CASES**

#### **A. CASE SELECTION AND COMPARISON FACTORS**

Colombia is not alone in the failures to effectively combat terrorism. Other examples of terrorist movements democracies dealt with poorly were the “Sendero Luminoso” (Shining Path) (SL) in Peru, and the Irish Republican Army (IRA) in Northern Ireland, Great Britain. Besides the flaws in the democratic processes, other factors have facilitated terrorism in these countries, such as the economic processes and system, the operations of financial markets, and the banking systems. This chapter compares the selected factors listed in Figure 2 across two additional countries in an effort to examine how terrorist organizations have taken advantage of the gaps in these systems to raise their finances.

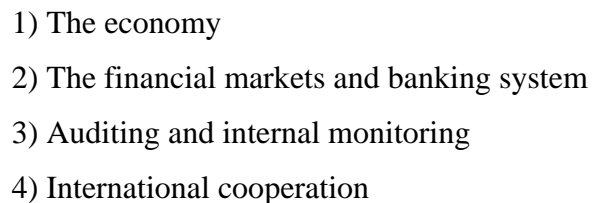
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- 1) The economy
  - 2) The financial markets and banking system
  - 3) Auditing and internal monitoring
  - 4) International cooperation

Figure 2. Case Examination Factors

The factors selected for comparing the effects of globalization and free markets on terrorist financing facilitation provided an effective means of analyzing how terrorists may be exploiting these systems. In each country, the governance and regime, the economy, the financial markets, and the banking systems are diverse enough to illustrate the realm of possible factors that terrorists have at their disposal. Policy makers can in turn use these factors identified in their efforts to counter terrorist financing and the development of international cooperation.

## **B. PERU'S SENDERO LUMINOSO**

### **1. Background**

In 1980, the SL emerged as a Leftist group with a mixed Maoist-Marxist ideology. As the ELN and FARC in Colombia initiated as a peasant rural movement against a repressive government, the SL movement in Peru invoked the indigenous people of Peru to take arms and revolt against the oppressive government who persistently failed to recognize their rights although they comprised more than fifty percent of the population.<sup>68</sup> The Peruvian government's tactics in dealing with SL were heavy-handed and indiscriminate resulting in further repression of the indigenous people's civil liberties.<sup>69</sup>

The Peruvian government sent in the military in 1982 as a response to the atrocities committed by SL. Unfortunately, the military was ill prepared and untrained on who they were to target, they did not speak the language nor had intelligence of the area, and they used torture tactics to extract the information from those they captured. As a result, SL revolted by inciting prisoners to act as well as conducting more acts of terror by presenting the movement as a "Just cause that is worth much more than an individuals life."<sup>70</sup> The counter effect was impunity for the army; military control was exerted over the indigenous areas and the extermination of whole villages took place.

The Peruvian government ignored the grievances of the poor and unrepresented class and used the military unsuccessfully to suppress the terrorist movement. The Peruvian government also armed the indigenous people of the Amazon so they could protect themselves from the SL. Notably, in Peru, the repression of civil liberties in the name of providing security caused a radical change from a democratic government to an authoritarian regime.

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<sup>68</sup> "State of Fear," Video presentation about Sendero Luminoso in Peru (Monterey, CA: Naval Postgraduate School, 2007), Fall Quarter 2007 International Terrorism Course, Presented November 26, 2007.

<sup>69</sup> Ibid.

<sup>70</sup> Ibid.

The SL does not exist in Peru to the extent that it did in the 1980s and 1990s but remnants do exist and have continued to launch attacks against the Peruvian government. More prominently, as reported by the U.S. State Department, in 2007, the SL was engaged in narco-trafficking and was responsible for the deaths of 11 police officers, 20 civilians and a member of the military.<sup>71</sup> In recent years, SL involvement in drug production and trafficking has provided funding. These funds facilitate SL operations, improve relations with local communities in remote areas, and facilitate the recruitment of new members.<sup>72</sup>

## **2. The Economy**

Peru's economy is diverse. However, overdependence on minerals and metals subjects the economy to fluctuations in world prices for these metals and commodities. Growth depends heavily on exports of minerals, textiles, and agricultural products, and on expectations for the success of natural gas and other potential energy projects under development. In addition, the lack of infrastructure deters trade and investment. The Peruvian economy grew by more than four percent per year during the period 2002-06. Growth jumped to 7.5 percent in 2007, driven by higher world prices for minerals and metals.<sup>73</sup>

In an effort to promote economic stabilization and liberalization policies, during the early 1990s, the Peruvian government lowered trade barriers, lifted restrictions on capital flows and opened the economy to foreign investors. As a result, Peru experienced marked growth in foreign investment from 1993-1998. In April 2002 of ProInversion, a robust privatization agency was established as part of a government effort to stimulate growth and investment.

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<sup>71</sup> United States State Department, "Country Reports on Terrorism 2007," (2007), <http://www.state.gov/s/ct/rls/crt/2007/103710.htm> (accessed in August 15, 2008).

<sup>72</sup> Ibid.

<sup>73</sup> Central Intelligence Agency, *CIA World Fact Book: Peru*, May 15, 2008, (2008), <https://www.cia.gov/library/publications/the-world-factbook/geos/pe.html#Econ> (accessed June 5, 2008).

Peru's poverty rate and underemployment are high. A reported 44.5 percent of the Peruvian population lived below the poverty line as of 2006. Also in 2006, unemployment was estimated at 7.4 percent in the country's capital while a reported widespread underemployment existed in the rest of the nation.

The currency of Peru is the Nuevo Sol (PEN). The PEN has traded with the U.S. dollar for the past five years as illustrated in Table 3 and has experienced little fluctuation in the exchange rate. Since the PEN has strengthened relative to the U.S. dollar, this may potentially provide an advantage in trade and investing to increase consumption in Peru.

Table 3. Historical Peruvian Nuevo Sol to U.S. Dollar Exchange Rate<sup>74</sup>

<i>Year</i>	<i>PEN/US\$1</i>
2003	3.4785
2004	3.4132
2005	3.2958
2006	3.2742
2007	3.1731

### **3. The Financial Markets and Banking System**

Considered competitive, the Peruvian banking industry offers services to business customers while the private sector has access to numerous and various credit instruments. In recent years, the demand for securities has greatly exceeded supply driving private pension funds to compete with financial companies for bonds issued by companies. From January through early December 2007, firms placed \$1.67 billion on the local bond market. By November 2007, pension funds managed a total of \$20.2 billion, a 47 percent

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<sup>74</sup> Central Intelligence Agency, *CIA World Fact Book: Peru*, May 15, 2008, (2008), <https://www.cia.gov/library/publications/the-world-factbook/geos/pe.html#Econ> (accessed June 5, 2008).

surge over the November 2006 level. In addition, the Central Bank of Peru has placed a 20 percent cap on pension fund investments abroad; thereby, providing Peruvian bond issuers, including the government, and loan seekers with a captive market.

The Peruvian banking system is generally considered sound. Through sensible supervision, combined with competition, a significant consolidation in the banking sector has emerged. The consolidation has revamped operations, increased capitalization, and reduced costs. Currently twelve commercial banks comprise the system and three banks account for just over three-fourths of loans and almost four-fifths of deposits. The system also has three specialized institutions and 39 thriving micro-lenders and savings banks. As of November 2006, foreigners had significant shares in nine banks, of which they were majority owners of four commercial banks. Total assets of the commercial banks were \$29.8 billion at the end of June 2007. As of November 2007, 1.3 percent of total loans were assessed as non-performing, down from a high of 11 percent recorded in 2001.<sup>75</sup>

Close families or associates generally control ownership of Peruvian corporations and hostile takeovers are practically non-existent. Larger private firms are known to use “cross-shareholding” and “stable shareholder” arrangements to restrict investment by those they consider outsiders. However, Peruvian law and regulations do not authorize or encourage private firms to adopt articles of incorporation or association to limit or restrict foreign participation. There are also no private or public sector efforts to restrict foreign participation in industry standards-setting organizations. Foreign direct investment registered with ProInversion as of the end of 2006 was \$15.37 billion. According to U.S. State Department analysis, ProInversion estimated growth of private foreign direct investment would reach \$20.00 billion in 2008. Foreign dematerialized holdings of securities totaled \$9.6 billion in October 2006.<sup>76</sup>

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<sup>75</sup> United States State Department, “2008 Investment Climate Statement – Peru,” (2008), <http://www.state.gov/e/eeb/ifd/2008/100999.htm> (accessed on June 5, 2008).

<sup>76</sup> Ibid.

#### **4. Internal Auditing and Monitoring**

The National Commission for the Supervision of Companies, Securities and Exchanges, (CONASEV) is the Peruvian government entity charged with the study, promotion, and regulation of the securities and commodities markets. Additionally, CONASEV is charged with the control of market participants, the maintenance of a transparent and orderly market, the setting of accounting standards and the publication of financial information about covered companies. All firms, listed on the Lima Stock Exchange or the Public Registry of Securities, are vetted by CONASEV.

Stock issuers are required to inform CONASEV and the relevant stock exchange in charge of supervising the centralized trading mechanism of events that affect or might affect the stock, the company, or any public offerings. The end state of these requirements is to promote market transparency, and prevent monopolies and fraud.<sup>77</sup>

#### **5. International Cooperation**

Peru has ratified both the United Nations Convention against Corruption and the Organization of American States' Inter-American Convention against Corruption. Peru is not a member of the Organization of Economic Cooperation and Development (OECD), and nor has signed the OECD Convention on Combating Bribery. Like Colombia, Peru is a member of GAFISUD and works toward meeting the FATF Forty plus Nine Special Recommendations for combating money laundering and terrorist financing. As concerns compliance with the implementation of the FATF Forty plus Nine Special Recommendations, Peru was found 65 and 50 percent compliant, respectively.<sup>78</sup>

Peru is also one of the four nations worldwide participating as a pilot country in the G8 anti-corruption and transparency initiative. An action plan encompassing the following six areas was develop with assistance from the G8 partners and Non

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<sup>77</sup> United States State Department, "2008 Investment Climate Statement – Peru," (2008), <http://www.state.gov/e/eeb/ifd/2008/100999.htm> (accessed on June 5, 2008).

<sup>78</sup> Jackie Johnson, "Is the global financial system AML/CFT prepared?" *Journal of Financial Crime*, 15(1) (2008): 7-21, in the ABI/INFORM Global database (Document ID: 1440894781) (accessed June 10, 2008).

Governmental Organizations: citizen information/internet connectivity; improving central government fiscal transparency; developing government of Peru procurement systems; improving regional/local government transparency and management; improving transparency of extractive industry revenues; and developing asset forfeiture systems and legislation.<sup>79</sup>

## **6. Analysis**

The Peruvian people did not experience equality, liberty, and the rule of law. They were subjugated to a militant dictatorship whose leader was ultimately interested in self-preservation and not the preservation of democracy. This provided the landscape for SL to exist and seize control of the rural areas of the country. Consequently, through control of the rural parts of the country, SL has also taken control of the production and distribution of cocaine, which is quite profitable.<sup>80</sup>

Although the SL does not exist in Peru to the extent that it did in the 1980s and 1990s, remnants do exist. Of particular concern are the levels of possible monetary incentives that the SL may offer and provide to the numerous Peruvians living in poverty (from earlier in this study a reported 44.5 percent of the population live in poverty). The inherent risk for the government of Peru is that the current wave of SL members picks up momentum and the required financing through the lucrative narcotics black market. The SL may readily exploit the poor and have them engage in the same type of illicit activities as were hypothesized for Colombia. Some of those financing activities may include establishing bank accounts through which small amounts of unlawful money can enter virtually undetected through international remittance or small cash transactions. They can become legitimate figureheads of fictitious enterprises or even legitimate businesses

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<sup>79</sup> United States State Department, "2008 Investment Climate Statement – Peru," (2008), <http://www.state.gov/e/eeb/efd/2008/100999.htm> (accessed on June 5, 2008).

<sup>80</sup> United States State Department, "Country Reports on Terrorism 2007," (2007), <http://www.state.gov/s/ct/rls/crt/2007/103710.htm> (accessed in August 15, 2008).



whose licit purpose is to launder money. They may also become the “mules” that transport the unlawful money for currency conversion, or just transport cocaine across the world.<sup>81</sup>

The familial ties in the Peruvian corporate world may provide a formidable barrier to entry for the SL to engage in financing their activities through the securities and futures markets and business. However, depending on the monetary leverage SL may have in the international arena through its narcotics enterprise, SL may have the capacity to setup legitimate companies abroad that conduct business with Peruvian corporations. SL would then be able to engage in simulated foreign investment in a local company.<sup>82</sup> In such a case, the SL may take advantage of a local company in financial need or difficulty and provides economic backing from the foreign company. The foreign funds would legitimately enter the country and the local company would have to pay the debt plus interest. SL would have laundered its illicit funds and potentially made a further profit because of the added interests.

Although the Peruvian economy and banking system are assessed as performing soundly and very low volatility is seen in the PEN to U.S. exchange rate for the past five years, the Peruvian government must continue to be vigilant and proactive in combating terrorism and meeting the requirements of GAFISUD. If the upper class in Peru continues to prosper while little is gained in an effort to relieve the plight of the poor, then SL may potentially have the opportunity to grow to what it once was. Given the large number of foreign owned banks in Peru, this provides the SL the required access to their international financing activities (i.e., remittance of illicit funds from the exportation of drugs worldwide). Technological advances and the connectivity amongst financial institutions worldwide also facilitate SL’s movement and control funds around the world through the simple use of computer. In addition, the purchase of foreign currency is a likely tactic for the SL to launder drug money smuggled into the country. The drug

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<sup>81</sup> GAFISUD, “Regional Typologies – GAFISUD 2005,” (2005), <http://www.gafisud.org/tipologias.asp?idseccion=8> (accessed August 13, 2008).

<sup>82</sup> Ibid.

money can be dispersed amongst several individuals or small front businesses and they may legitimately purchase foreign currency while effectively laundering the illicit funds.

## **C. GREAT BRITAIN'S IRISH REPUBLICAN ARMY**

### **1. Background**

The Irish Republican Army (IRA) emerged from both real and perceived inequalities experienced by the Catholics in Northern Ireland in the 1960s and forward. The sentiment amongst the Catholics was of unequal treatment under the existing British law and so they embarked on a civil rights movement in 1968 with the slogan of “one man, one vote.”<sup>83</sup> However, as described by Paul Arthur, the system at the time in Northern Ireland was such that only those who paid local taxes had the right to vote. The Catholics typically were the poorer citizens, lacked jobs, did not pay taxes, and therefore, could not vote in local elections. The idea of “one man, one vote” threatened the status quo and political power of the Northern Ireland Protestants whom believed this would lead to the revival of the “old Nationalist and Republican cause of [uniting] Ireland.”<sup>84</sup> Inevitably, by reacting with strong opposition against the Catholics’ demand, the local Northern Ireland government accomplished what they sought to crush or avoid, which was the emergence of the IRA.

Key events changed the landscape under which the IRA operated once Catholics saw that the concessions promised by the British government under the civil rights campaign were slow in coming. As the Catholics weariness with both the British and Belfast governments grew, so did the desire by the IRA for “more punitive military action.”<sup>85</sup> The need for more militant action was answered in “the Battle of the Bogside”

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<sup>83</sup> Paul Arthur, “Behind the Mask: the IRA and Sinn Fein “The Conflict,” *PBS and WBH Frontline* (1998), <http://www.pbs.org/wgbh/pages/frontline/shows/ira/conflict/> (accessed November 13, 2007).

<sup>84</sup> Paul Arthur, “Behind the Mask: the IRA and Sinn Fein “The 1968 Civil Rights Movement,” *PBS and WBH Frontline* (1998), <http://www.pbs.org/wgbh/pages/frontline/shows/ira/conflict/> (accessed November 13, 2007).

<sup>85</sup> *Ibid.*

and “the Burnings in Belfast” in 1969 and later “Bloody Sunday” in 1972.”<sup>86</sup> In all three instances, the Catholics became convinced that they would not find justice and equality in Northern Ireland as presented by the British Army’s excessive use of force against them using tear gas at the Bogside and Belfast and the killing of unarmed civilians during a civil rights march.<sup>87</sup> Rather than uphold the civil liberties of all its citizens, the British government became a repressor for all Catholics in Northern Ireland.

The Catholics in Northern Ireland did not trust the British or the Belfast central governments to provide protection nor ensure equality for all. The overreaction of the British Army, once viewed as protectors, became the catalysts for an all out urban war with the IRA. The vehicles of democracy failed to acknowledge the true civil status of the poor Catholics in Northern Ireland. Once more what was seen were those in power refusing to yield or share it due to a long history (the scope of which cannot be covered in this study) of strife between the Catholics and Protestants in Ireland.<sup>88</sup> The Protestant elite with their control of the government in Belfast refused to see the benefits of any concessions to the Catholics’ requests, and the Catholics grew impatient with what little the Belfast, and British governments actually did for them. In Northern Ireland, all three pieces, equality, liberty, and rule of law, that embody democracy, failed and terrorism was able to flourish.<sup>89</sup>

## **2. The Economy**

Great Britain, a leading trading power and financial center, is one of the quintet of trillion dollar economies of Western Europe. Over the past two decades, the government

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<sup>86</sup> Paul Wilkinson, “Terrorism Versus Democracy: The Liberal State Response,” (London: Frank Cass Publishers), 2001; Paul Arthur, “Behind the Mask: the IRA and Sinn Fein, The 1968 Civil Rights Movement,” *PBS and WBH Frontline* (1998), <http://www.pbs.org/wgbh/pages/frontline/shows/ira/conflict/> (accessed November 13, 2007).

<sup>87</sup> Paul Arthur, “Behind the Mask: the IRA and Sinn Fein “The Conflict,” *PBS and WBH Frontline* (1998), <http://www.pbs.org/wgbh/pages/frontline/shows/ira/conflict/> (accessed November 13, 2007).

<sup>88</sup> Paul Arthur, “Behind the Mask: the IRA and Sinn Fein, “The History of this Conflict,” *PBS and WBH Frontline* (1998), <http://www.pbs.org/wgbh/pages/frontline/shows/ira/conflict/> (accessed November 13, 2007).

<sup>89</sup> Michael Freeman, “Democracy, Al-Qaeda, and the Causes of Terrorism,” *Studies in Conflict and Terrorism*, forthcoming, 2007, 1-37. Michael Freeman is Assistant Professor at the Naval Postgraduate School Defense Analysis Department.

has greatly reduced public ownership and contained the growth of social welfare programs. The current government has been speeding up the improvement of education, health services, and affordable housing at a cost in higher taxes and a widening public deficit. In 2006, an estimated 14 percent of the population lived below the poverty line and the unemployment rate was estimated at 5.4 percent in 2007.<sup>90</sup>

The British Pound is a strong currency and has traded with the U.S. dollar in the past five years as illustrated in Table 4 ranging from 0.6125£/US\$1 in 2003 with a moderate decline across the years to 0.4993£/US\$1 in 2007.

Table 4. Historical British Pound to U.S. Dollar Exchange Rate<sup>91</sup>

<i>Year</i>	<i>£/US\$1</i>
2003	0.6125
2004	0.5462
2005	0.5493
2006	0.5418
2007	0.4993

### 3. Financial Market and Banking System

London houses one of the largest and most comprehensive financial markets. London offers all forms of financial services: commercial banking; investment banking; insurance; venture capital; stock and currency brokers; fund managers; commodity dealers; accounting and legal services; as well as electronic clearing and settlement systems and bank payments systems.<sup>92</sup> Great Britain's banking sector is the largest in

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<sup>90</sup> Central Intelligence Agency, *CIA World Fact Book: United Kingdom*, May 15, 2008, (2008), <https://www.cia.gov/library/publications/the-world-factbook/geos/uk.html#Econ> (accessed June 5, 2008).

<sup>91</sup> Ibid.

<sup>92</sup> United States State Department, "2008 Investment Climate Statement – United Kingdom," (2008), <http://www.state.gov/e/eeb/ifd/2008/101025.htm> (accessed June 5, 2008).

Europe, with some 350 banks authorized to do business in the country. The total assets of Great Britain's banking sector were approximately \$12.4 trillion in 2006, with domestic banks accounting for about 46 percent.<sup>93</sup>

On November 1, 2007, the European Union's Markets in Financial Instruments Directive (MiFID) law came into effect. The MiFID law gives "European Union securities exchanges, multilateral trading facilities and investment firms a "single passport" to operate throughout the European Union (EU) on the basis of authorization in their home Member States."<sup>94</sup> Although Great Britain is not a member of the EU, the passage of the MiFID has a direct impact on who conducts business with Great Britain across EU markets.

#### **4. Internal Auditing and Monitoring**

Regulations on legal, regulatory and accounting standards are published and are applied by the single regulatory body, the Financial Services Authority. In terms of accounting standards and audit provisions, as of January 1, 2005, firms in Great Britain must use the International Financial Reporting Standards (IFRS) set by the International Accounting Standards Board (IASB) and approved by the European Commission.<sup>95</sup>

The information required to open an account in Great Britain's banking system is not rigorous; however, monitoring is. Applicants must provide an official identification, such as a passport, a local address and for foreigners both a local and foreign address as well as a banking reference letter from their foreign residency. Banks have the means of cross-referencing the information provided by the applicant with other national banks as well as some international banks based on international banking agreements. In accordance with the Proceeds of Crime Act 2002, financial institutions are required to submit Suspicious Activity Reports to the national level Serious Organized Crime

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<sup>93</sup> United States State Department, "2008 Investment Climate Statement – United Kingdom," (2008), <http://www.state.gov/e/eeb/ifd/2008/101025.htm> (accessed June 5, 2008).

<sup>94</sup> United States State Department, "2008 Investment Climate Statement – European Union," (2008), <http://www.state.gov/e/eeb/ifd/2008/100862.htm#twentyseven> (accessed June 7, 2008).

<sup>95</sup> United States State Department, "2008 Investment Climate Statement – United Kingdom," (2008), <http://www.state.gov/e/eeb/ifd/2008/101025.htm> (accessed June 5, 2008).

Agency on suspicious transactions detected/suspected within their organization.<sup>96</sup> The financial institutions warn clients of the ways in which privileged information provided as part of the application process may be used.<sup>97</sup>

## **5. International Cooperation**

Great Britain subscribes to the OECD Committee on Investment and Multinational Enterprises' National Treatment Instrument and the OECD Code on Capital Movements and Invisible Transactions (CMIT). The principles involved in legal, regulatory, and accounting systems are transparent, and they are consistent with international standards. Great Britain's Accounting Standards Board provides guidance to firms on accounting standards and works with the IASB on international standards.<sup>98</sup> Great Britain is also a member of the FATF. To date, of the three countries under comparison in this study, Great Britain is the most compliant with the implementation and ratification of the UN Resolutions in accordance with the FATF Forty plus Nine Special Recommendations.<sup>99</sup> In comparison with FATF members as well as non-members, with the same purpose of combating money laundering and terrorist financing, Great Britain was on average 70 percent compliant with implementation of the Forty Recommendations and 82 percent compliant with implementation of the Nine Special Recommendations.

## **6. Analysis**

In an effort to provide protection to the people of Northern Ireland, the British government overreacted and was heavy handed. The overreaction was in part due to the lack of understanding of long existent friction between the Catholics and Protestants in

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<sup>96</sup> "Serious Organized Agency, United Kingdom" <http://www.soca.gov.uk/>, (accessed June 8, 2008).

<sup>97</sup> HSBC Bank, United Kingdom, Passport account application, [http://www.hsbc.co.uk/1/2/personal/current-accounts/passport/passport-apply;jsessionid=0000fOcpoMN\\_dIC9rOrh-p-a-Xv:12c58t1e1#know](http://www.hsbc.co.uk/1/2/personal/current-accounts/passport/passport-apply;jsessionid=0000fOcpoMN_dIC9rOrh-p-a-Xv:12c58t1e1#know) (accessed June 8, 2008).

<sup>98</sup> United States State Department, "2008 Investment Climate Statement – United Kingdom," (2008), <http://www.state.gov/e/eeb/ifd/2008/101025.htm> (accessed June 5, 2008).

<sup>99</sup> Jackie Johnson, "Is the global financial system AML/CFT prepared?" *Journal of Financial Crime*, 15(1) (2008): 7-21, in the ABI/INFORM Global database (Document ID: 1440894781) (accessed June 10, 2008).

Northern Ireland. Both the British government and the Catholic community experienced real and perceived threats to their survival in Northern Ireland. The British government took a leap from non-involvement to outright military intervention. To the Northern Ireland Catholics, the fight became one for their survival rather than for simply civil liberties.

There was no rule of law, civil society, strong state, or needed rules and ideals since the Catholics felt they were under siege from the Protestants and British government; in their view, the needed rules and ideals only seemed to benefit the Protestants. Free flow of information consisted of self-reinforcing information within the Catholic enclaves. Lastly, for the Catholics, there was no sustainable economic and social development in Northern Ireland since the existing laws did little to allow them to be part of the democratic process that enabled sustainable economic and social development.

The economic condition for Catholics in Northern Ireland rendered the alternative for raising funds and financing the IRA activities through criminal endeavors as well as establishing their own legitimate businesses.<sup>100</sup> Today, there appears to be little evidence from examining the British economy and financial institutions and instruments that criminals or terrorists such as the IRA could readily exploit them for financial gain. However, what does render Great Britain vulnerable to illicit criminal and financial activity is its business dealing with neighbors across the globe whose control mechanisms are weak. The notable exploitable vulnerabilities of the British economy and financial institutions include the passing of the MiFID in the EU and the low levels of implementation of the FATF Forty plus Nine Special Recommendations by other FATF members. The MiFID law allows for a high potential of transnational illicit financing and money laundering activities given the “single passport” in the EU.<sup>101</sup>

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<sup>100</sup> Ted Robert Gurr, *The Roots of Terrorism: Economic Factors*, ed. Louise Richardson, (Club de Madrid, 2006), 94. “The Provisional IRA had an estimated \$10 million per annum in funding...some of it from abroad but mostly gained from robberies and racketeering as well as extortion and kidnapping, welfare fraud, and running illegal drinking clubs. The IRA also branched out into legitimate businesses.”

<sup>101</sup> United States State Department, “2008 Investment Climate Statement – European Union,” (2008), <http://www.state.gov/e/eeb/ifd/2008/100862.htm#twentyseven> (accessed June 7, 2008).

As pointed out earlier, Great Britain has the highest compliance rate of implementation of the FATF Forty plus Nine Special Recommendations of the three countries studied. Additionally, Great Britain is among the top four countries with the highest compliance rate of implementation of the FATF Forty Recommendations and has the top compliance rate of implementation of the Nine Special Recommendations.<sup>102</sup> However, low compliance by other nations allows infiltration of weaker financial markets, and consequently, renders Great Britain vulnerable. This phenomenon though is not unique to Great Britain but is symptomatic of the varying degree of vulnerability of all world markets and banking institutions through globalization and the varying levels of weaknesses in all systems.

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<sup>102</sup> Jackie Johnson, "Is the global financial system AML/CFT prepared?" *Journal of Financial Crime*, 15(1) (2008): 7-21, in the ABI/INFORM Global database (Document ID: 1440894781) (accessed June 10, 2008).



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## **IV. LOOKING AHEAD – CONCLUSIONS AND RECOMMENDATIONS**

### **A. CONCLUSIONS**

As Dobriansky pointed out, “States with liberal institutions and democratic systems can...respond to terror with greater public support and, in the long run, greater effectiveness than authoritarian states can.”<sup>103</sup> In all three cases, in Colombia with the emergence of the FARC, ELN, and AUC, in Peru with SL, and in Great Britain with the IRA, the democratic governments initially had failures combating terrorism. This was primarily due to an inadequate use of the tools at their disposal and dismissing terrorism as a problem of the poor and under-represented.

In Colombia, Peru and Great Britain, the governments were heavy handed through use of the military. In all cases, there was an endemic mistrust of civic leaders and government officials. This was rooted in the repressive history, endemic corruption of civic leaders and government officials, and the disproportionate balance of power between the elite and the underprivileged. A nation without civil liberties, equal representation of all its constituents, and rule of law and security, or sense of security, can be the breeding ground for terrorism. This was true in all three cases, where groups within the society felt their grievances were not being addressed by the political mechanism in place. Since the governments of Colombia, Peru and Great Britain allowed lawlessness to rise up, they provided fertile ground for the FARC, ELN, AUC, SL, and IRA elements to thrive.

The economy and monetary systems are relatively stable in all three nations. There is no indication in the literature that any is at risk of an economic downfall. In all three cases today, there appears to exist a sense of confidence in the government as well as the legislation and reforms for economic growth and stability with the rest of the

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<sup>103</sup> Paula J. Dobriansky, Henry A. Crumpton, and F. Gregory Gause III, “Tyranny and Terror,” *Foreign Affairs*, 85(1) (2006): 135-138, in the ABI/INFORM Global database (Document ID: 979177711) (accessed October 27, 2007).

world. However, the sense of confidence in the government, economy, and financial institutions and markets must be tempered with adequate internal and external controls. Terrorist and criminal organizations fully take advantage of all these mechanisms to finance their activities. Terrorists invest in the stock markets, they funnel money and goods (or drugs and other contraband) through legitimate businesses or shell companies, and they can purchase and sell real estate.<sup>104</sup> In a thriving economy, such endeavors can and do finance terrorists.

Of concern in both Peru and Colombia is the percentage of the populations at or below the poverty line. Although there is no correlation or causation between poverty and those engaging in terrorism, if the poor in these two countries are marginalized without a means to surpass their social status, they may opt to engage in activities with any of the criminal or terrorist entities within their countries.<sup>105</sup> It is necessary to heed Saighal's warning, "the inequitable distribution of global wealth will continue to be reckoned as one of the causes that leads to greater global unrest, a condition that makes it easier for the recruitment of unemployed and frustrated people for taking up arms against the established order."<sup>106</sup> These frustrated potential recruits may not necessarily engage in the terrorist activities of the FARC, ELN, AUC or SL, but they may find it profitable to be intermediaries for the terrorists' money laundering activities. Poor disenchanting people can establish bank accounts through which small amounts of unlawful money can enter virtually undetected through international remittance. They can lend themselves to be the legitimate figureheads of fictitious enterprises or even legitimate businesses whose licit purpose is to launder money. They may lend themselves to be the "mules" that transport the unlawful money for currency conversion. Or if not, by transporting illicit funds, they may transport illegal narcotics.<sup>107</sup>

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<sup>104</sup> GAFISUD, "Regional Typologies – GAFISUD 2005," (2005), <http://www.gafisud.org/tipologias.asp?idseccion=8> (accessed August 13, 2008).

<sup>105</sup> Of note, the 9/11 airplane hijackers all came from prominently educated middle and upper class families.

<sup>106</sup> Vinod Saighal, *Dealing With Global Terrorism: The Way Forward* (Elgin, IL: New Dawn Publishing, 2004), 149.

<sup>107</sup> GAFISUD, "Regional Typologies – GAFISUD 2005," (2005), <http://www.gafisud.org/tipologias.asp?idseccion=8> (accessed August 13, 2008).

The Colombian and Peruvian markets are small and emerging while the London market is much more developed. In Peru and Colombia, private investment and savings is not widespread potentially rendering detection of illicit monetary activities a much simpler task than in Great Britain. Detection would be particularly noticeable if there were an increase or established pattern in the amounts placed in the banks as well as withdrawn. However, the technology necessary to integrate all financial institution information is extremely costly.

In all three cases, the stability of the banking and financial systems render investing and engaging in business transactions a profitable endeavor. However, a possible deterrent in the Colombian banking sector is the taxation of withdrawals from checking and savings accounts. In Colombia, this may push money launderers to engage in either low-income housing purchases or sales and purchases of foreign currency, which are not subject to tax. The purchase of foreign currency is a very likely tactic, especially for the FARC and ELN, to launder drug money smuggled into the country. The illicit cash can be dispersed amongst several, presumably reputable, individuals or corporations so that they may legitimately purchase the foreign currency and effectively launder the money. Another alternative terrorist organizations may engage in to raise their finances is the purchase of stocks going through an intermediary broker or corporation to ensure the activity appears legitimate. By using intermediaries or legitimate businesses, the financial markets are wide open for terrorists to hedge funds and potentially increase their capital in a prospering economy.

The highest level of risk in Colombia for illicit financing activities lies within the financial institutions. This is due to the lack of verification of transactions between financial institutions. The key necessity is entry into a financial network through bribery, extortion, or coercion of employees in key positions and access, which may be a simple task for criminal elements or terrorists. Once inside the institution, transfers and transactions from one bank to another are not scrutinized due to the mutual assumptions and expectations that all institutions are abiding by the law and the “Know Your Client” requirements. Once in the financial institution, terrorists can deposit money from illicit activities and move the funds around the world. The use of automatic teller cards

facilitates the location from or to which funds are moved without having to physically have the money. Terrorists, through their intermediaries, can purchase cashiers checks to make payments without leaving a trace that the original funds were illicit.

Combating terrorist financing is clearly a global problem with varying degrees of threat to stable societies. Colombia, Peru, and Great Britain are but a small representative sample of developed countries across the world vulnerable to the exploits of both criminal and terrorist entities. The FARC, ELN, and SL can readily use their country's or other country's established financial markets and banking institutions to raise capital, launder money, and engage in transnational financing. These terrorist organizations will actively search for countries whose financial internal and external controls are weak and exploit them. Maintaining legitimacy and sovereignty is at the forefront of each nation's goals. However, given the interconnectivity and interdependency amongst nations for economic growth due globalization, nations must find a way to work together and collaborate.

The Financial Action Task Force on Money Laundering (FATF) is at the forefront of the global economy with regards to combating money laundering and terrorist financing and presents viable mitigation tactics for nations through the Forty plus Nine Special Recommendations. However, FATF lacks any authority to ensure nations adhere to and implement the Forty plus Nine Special Recommendations. It is up to each separate nation to commit to and take action on the implementation of these recommendations. In this study, it is already seen that the vast divergence amongst Colombia and Peru, both members of GAFISUD, and between Great Britain, member of the FATF, when it comes to combating terrorism and money laundering. See Table 5 for a synopsis of each country's percent compliance compared to the global average. Of note in Great Britain's case is the disparity in implementation compliance amongst these countries. Although Great Britain's implementation is high, low compliance by other nations allows infiltration of weaker financial markets and consequently renders Great Britain vulnerable. This phenomenon though is not unique to Great Britain but is symptomatic of the varying degree of vulnerability of all world markets and banking institutions through globalization and the varying levels of weaknesses in all systems.

Table 5. Comparison of FATF Compliance<sup>108</sup>

<i>Country</i>	<i>FATF Forty Recommendations Compliance</i>	<i>FATF Nine Special Recommendations Compliance</i>
Colombia	63%	17%
Peru	65%	50%
Great Britain	70%	82%
Global Average	58%	51%

Great Britain pledged to implement FATF recommendations in the late 1980s and early 1990s and has had more time to implement the recommendations.<sup>109</sup> However, the divergence in implementation amongst all FATF and GAFISUD member countries may indicate where in each nation's priorities lies combating terrorism and money laundering. Presumably, the extent to which all countries are successful and implement the Forty plus Nine Special Recommendations will not only ensure each individual country's security but also their neighbors across the globe.

## B. RECOMMENDATIONS

The international community must take a different approach concerning the idea that democratization will eliminate terrorism. The three cases presented here illustrated that in certain cases, the democratic environment may actually facilitate terrorist activity. As scholars have already pointed out, it is not democracy but the elements that provide liberty, equality, and rule of law to all people in any form of government that dissuade or eliminate organization's option to resort to terrorism. More importantly noted in this study to successfully and legitimately provide liberty, equality, and rule of law for all, nations must be willing to look beyond their self-interests and view the needs of the international environment and their role in making it better. The international bodies established to accomplish this monumental task must be given the necessary instruments

<sup>108</sup> Data for this table were derived from Jackie Johnson (2008). Third round FATF mutual evaluations indicate declining compliance, *Journal of Money Laundering Control*, 11(1), 47-66 in the ABI/INFORM Global database (Document ID: 1440896701) (accessed June 10, 2008).

<sup>109</sup> Jackie Johnson, "Is the global financial system AML/CFT prepared?" *Journal of Financial Crime*, 15(1) (2008): 7-21, in the ABI/INFORM Global database (Document ID: 1440894781) (accessed June 10, 2008).

that will ensure compliance. Like any system or organization, if there is no buy in from the stakeholders, then the system or organization will never get off the ground, much less survive to accomplish what it was set up to do.

Implementation of the FATF Forty plus Nine Special recommendations is essential to deny terrorists the opportunity to exploit global financial instruments. However, there is no guarantee that each nation will actually implement all the recommendations or that it has the capacity to implement them. The disparity in implementation of just the three countries under observation in this study can attest to this.

Gathering and sharing information among nations about terrorists and their financing activities is clearly an effective tool. The FATF recognized that early and embedded this requirement in FATF Special Recommendation number five (see Table 1). By continuing to leverage this recourse locally and at the international level, nations may have further successes in detecting terrorist financing structures and mechanisms. This may also increase the level of collection of further information from those already in custody for terrorist activities and their financing. Given the interdependency among nations because of globalization, those nations with the technology and control systems in place to combat, detect, and deter terrorist financing must seriously consider sharing it with and assisting less developed countries in their implementation.

A rather radical approach not considered in this study or by the FATF is the legalization, and subsequent rigorous control and taxation, of certain illicit commodities that terrorists and criminals exploit to finance their activities. The impact of which would make for a controversial and interesting study. Another follow on study may examine the progress of a single nation in implementing the FATF recommendations compared to data on how criminal and terrorist organizations, within the same country, adapt and evolve their financing activities.

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